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No. 91-591

IN THE

Supreme Court Of The United States

October Term, 1991

INSLAW, INC.,

Petitioner,

v.

UNITED STATES OF AMERICA and
UNITED STATES DEPARTMENT OF JUSTICE,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

REPLY BRIEF IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

Michael E. Friedlander
Counsel of Record
Charles R. Work
Jacqueline E. Zins
Seth D. Greenstein
McDERMOTT, WILL & EMERY
1850 K Street, N.W.
Suite 500
Washington, D.C. 20006
(202) 887-8000

Philip L. Kellogg
James L. Lyons
KELLOGG, WILLIAMS
& LYONS
1275 K Street, N.W.
Suite 825
Washington, D.C. 20005
(202) 898-0722

Counsel for Petitioner

Balmar Legal Publishing Divsion, Washington, D.C. 20005 (202) 659-3610

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ARGUMENT[1]

The opposition filed by the United States Department of Justice ("Department") fails to refute the errors of law committed by the court of appeals that undermined, in fundamental ways, essential features of the bankruptcy system and the basic powers of the bankruptcy courts. Review by this Court is needed to reverse these anomalous holdings and confirm the jurisdiction of the bankruptcy courts to remedy interferences with bankruptcy reorganization.

[1] All parties are named in the caption. INSLAW has no parent companies, subsidiaries or affiliates.

1. There is no dispute that the automatic stay, 11 U.S.C. § 362(a)(3), comes into effect upon filing of the bankruptcy petition, and that it applies only to post-petition conduct. Nor is there a dispute that this section broadly proscribes "any act ... to exercise control over property of the estate," including property in the hands of a third party. Pet. 11-13; Opp. 14.[2] The Department seeks to evade the reach of the automatic stay by arguing that (1) the lower courts premised their holdings on pre-petition misconduct; (2) the stay could not be violated by an exercise of control over property obtained pre-petition by one who articulates a claim of right to that property; and, (3) the express statutory limits on the turnover remedy also restrict the automatic stay. Opp. 7-8, 10-11.

a. Contrary to the Department's position, the lower courts specifically found that the Department's acts that violated the automatic stay took place post-petition.[3] They were the Department's unauthorized copying and installation of INSLAW's trade secret software in 25 additional U.S. Attorney's Offices around the United States, and the Department's public disparagement of INSLAW's ownership rights to its privately-developed trade secret software.

b. The Department's argument that the stay could not be violated where a party in possession of the estate's property articulates a claim of right to that property, regardless of whether the property was fraudulently obtained and the claim was raised in bad faith, makes no sense. By this logic, a bankruptcy court would be rendered powerless to protect a debtor, or even to proceed with a reorganization effort, by the mere gainsaying of

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[2] As the court of appeals recognized, INSLAW retained proprietary rights in its trade secret software, which constituted "property of the estate" under section 541 of the Bankruptcy Code. Pet. App. 12a.

[3] As the district court observed, the events and facts leading up to the bankruptcy placed the post-petition misconduct in context, but "the focus of the review [was] on the actions taken by the Justice Department once INSLAW filed its petition for bankruptcy." Pet. App. 49a.

the debtor's rights. As a result of this reasoning, the bankruptcy proceeding must grind to a halt while the third party's claim is adjudicated by another court.

Not surprisingly, this argument finds no support in the plain language of section 362(a)(3). As explained in the petition at 11-13, the automatic stay was intended by Congress as a broad remedial statute to protect the rights of the debtor in property of the estate. The plain language proscribes *any* act to exercise control over property of the estate, and contains no special exceptions for exercises of control over "unadjudicated" or "disputed" property interests. Courts therefore apply the stay to remedy any type of incursion upon tangible and intangible property rights of the estate. Pet. 11-12 and n.7-8. If, as the Department suggests, "the ramifications of INSLAW's position are sweeping," Opp. 9, it is only because of the sweeping ramifications of the automatic stay itself.[4]

The Department's position also collides head-on with section 362(d), which requires parties who claim rights in property of the estate, regardless of the basis of the claim, to affirmatively seek relief from the automatic stay in the bankruptcy court. Parties who unilaterally pursue such asserted rights, and are thereafter proved wrong, risk violating the stay. Pet. 13-15. Thus, although the United States asserted a valid lien in *United States v. Whiting Pools*, 462 U.S. 198 (1983), the United States had an obligation "to seek protection of its [pre-petition] interest according to the congressionally established bankruptcy procedures, rather than by withholding the seized property from the debtor's efforts to reorganize." *Id.* at 212.[5] Similarly, in *In re*

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[4] Notably, the Department failed to address the well-settled case law holding that a party's good faith belief in its rights is irrelevant to whether a willful violation of the stay occurred. Pet. 15-16. In light of these authorities, any contention that merely disputing the debtor's rights defeats the automatic stay is plainly without merit.

[5] The Department erroneously asserts that the automatic stay was not at issue in *Whiting Pools*. Opp. 8 n.1. There, the United States recognized that

Computer Communications, 824 F.2d 725 (9th Cir. 1987), the court expressly recognized that a unilateral exercise of an asserted contractual right will violate the stay unless relief is first obtained from the bankruptcy court. The court in that case, and in *Small Business Admin. v. Rinehart*, 887 F.2d 165 (8th Cir. 1989), stressed the importance of this "fair and orderly process" in the bankruptcy scheme. Pet. 14-15.

The Bankruptcy Code intentionally placed the burden of asserting disputed rights upon the third party, and required that those rights be adjudicated in the bankruptcy court. This was done to avoid dissipating the assets of the estate and to assure uniformity of decisions affecting those assets. Pet. 15 and n.12. The position espoused by the court of appeals and the Department would reverse this salutary congressional policy; instead, it would place the burden on the debtor to first establish its rights in one or more other judicial forums, with the risk of conflicting decisions, before becoming entitled to the benefits of the automatic stay.

The position advanced by the court of appeals and the Department also would revive the system of "plenary jurisdiction" under the 1898 Bankruptcy Act, which held that "[i]f the property is not in the court's possession and a third person asserts a bona fide claim adverse to the receiver or trustee in bankruptcy, he has the right to have the merits of his claim adjudicated 'in suits of the ordinary character'...." *Cline v. Kaplan*, 323 U.S. 97, 98 (1944) (citation omitted).[6]

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the automatic stay prevented it from selling, in the post-petition period, property of the estate that was seized by and in possession of the United States in the pre-petition period. The case came before the bankruptcy court on the United States' motion for relief from the stay.

[6] Even under the 1898 Act, this Court recognized that "the mere assertion of an adverse claim does not oust the bankruptcy court of its jurisdiction. It has both the power and the duty to examine a claim adverse to the bankrupt estate to the extent of ascertaining whether the claim is ingenuous and substantial." *Cline v. Kaplan*, 323 U.S. at 99 (citations omitted). Here, the

Plenary jurisdiction intentionally was abolished by Congress in 1978. It was replaced with a distinction between matters founded upon rights and remedies provided by the Bankruptcy Code ("core" proceedings) and actions existing outside of bankruptcy law ("non-core" proceedings). Pet. 13-14 and n.11, 17-18. The relief requested by INSLAW – a determination that its trade secrets were "property of the estate" and remedies for violating the automatic stay – are core matters under the Bankruptcy Code that clearly could be adjudicated by the bankruptcy court. Pet. 17-18.[7]

c. The argument that the narrower provisions of the turnover statute, 11 U.S.C. § 542, restrict the intentionally broader scope of the automatic stay is wrong. First, the section 542(b) turnover cases relied upon by both the court of appeals and the Department are inapposite. These cases address only turnover of money debts, which is expressly limited by section 542(b) to debts that are undisputed – "matured, payable on demand or

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lower courts found that the basis of the Department's "contract dispute" was not ingenuous and substantial because it was the product of a willful, intentional and knowing fraud. Pet. App. 52a, 162a, 192a-193a, 205a, 228a-229a, 235a-236a.

[7] The Department, in its defense, asserted that its actions were justified by the contract. Yet, the Department did not dispute that the contract between the Department and INSLAW covered only public domain software, and did not require delivery to the government of INSLAW's trade secrets. Pet. App. 124a-125a. It did not dispute that under the contract the computer software was to be installed only in 20 U.S. Attorney's Offices. *Id.* The Department further conceded that, in the post-petition period, it copied INSLAW's trade secrets and installed them in 25 more U.S. Attorney's Offices that were not to receive the computer software under the contract. Pet. App. 226a. The only issues, then, were the core issues of whether INSLAW's proprietary trade secrets constituted "property of the estate" under section 541(a); and whether the Department's post-petition acts, taken without prior relief from the bankruptcy court, violated the automatic stay. In any event, the character of INSLAW's causes of action are defined by the complaint, and are not rendered a "contract dispute" by the Department's defenses. *See Megapulse v. Lewis*, 672 F.2d 959 (D.C. Cir. 1982). Pet. App. 40a-41a, 205a-206a.

payable on order."[8] By contrast, section 542(a), which covers turnover of tangible property, is not restricted to undisputed property interests. It applies to all property that may be used, leased or sold by the estate.

Second, the two statutes serve different purposes by different means. The automatic stay precludes, by negative injunction, a wide range of conduct affecting property interests of the estate. Turnover affirmatively mandates the return of property to the estate.[9] Turnover applies to a narrower range of circumstances than does the automatic stay, hence certain rights of turnover are expressly subject to the broader proscriptions of the automatic stay. *See* section 542(c).

In this regard, the United States wrongly asserts that INSLAW would "end-run" the turnover statute. While the automatic stay applies to *all* property of the estate, only certain types of property are eligible for turnover under section 542(a).[10] Yet nothing in either statute vitiates the automatic stay whenever turnover is not available.

Review in this Court therefore is needed to prevent the unwarranted encroachment by the court of appeals upon the

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[8] *In re Charter Co.*, for example, concerned recovery of money under a contract claim. 913 F.2d 1575, 1579 (11th Cir. 1990). However, the court of appeals in that case confirmed the jurisdiction of the bankruptcy court to rule on the contract claims as non-core matters — unlike the court of appeals here, which wrongly ordered INSLAW's complaint dismissed. *Infra*, at 7-8.

[9] Contrary to the Department's unsupported assertion, INSLAW has not suggested that the automatic stay, rather than the turnover statute, could be used to compel the return of property. Opp. 10. The automatic stay proscribes actions against property of the estate, and may require affirmative conduct to stop pre-petition actions whose consequences extend into the post-petition period. Pet. App. 220a-221a, 229a-230a.

[10] In this case, for example, the software in possession of the Department was custom designed for use by the Department and, so, could neither be used by INSLAW, nor leased or sold by the estate except to the Department. The intrinsic value of the tapes containing the software was inconsequential.

debtor protections under section 362(a) and a third party's obligations under section 362(d).

2. The Department's opposition totally ignores the second fundamental error created by the court of appeals' opinion; namely, the denial of the basic jurisdiction of a bankruptcy court to grant declaratory and injunctive relief and to hear related non-core matters. The Department's failure to address this clear intrusion on these primary powers of the bankruptcy court only buttresses INSLAW's argument that the court of appeals' decision in this regard be summarily reversed.

The Department wrongfully argued that violation of the automatic stay was "the only ground for recovery asserted." Opp. 12.[11] In fact, INSLAW's first cause of action sought a declaratory judgment, pursuant to 11 U.S.C. § 105, that its trade secret software was the exclusive property of the estate under section 541 of the Bankruptcy Code. This request for declaratory relief was made without regard to the automatic stay. This claim constituted a separate core proceeding that undeniably could be determined by the bankruptcy court, and the court of appeals' rejection of this basic jurisdiction was clearly erroneous. Pet. 18-21.

The court of appeals also erroneously denied the bankruptcy court's authority to hear INSLAW's claims as non-core matters subject to *de novo* review. 28 U.S.C. § 1334(b);

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[11] The Department misstates the holdings of the bankruptcy court, as if that court found culpable only a "failure to cure pre-petition fraud." Opp. 4. This mischaracterization completely ignores the principal holding in the case, to wit, that the Department violated the stay by copying, disseminating and continuing to use INSLAW's proprietary trade secrets (*i.e.*, property of the estate), without right, in the post-petition period. Pet. App. 226a. This post-petition misconduct alone entitled INSLAW to the injunctive relief and damages awarded by the court. *Id.* The bankruptcy court did find that a separate and additional violation of the stay occurred by the Department's failure to cure its pre-petition fraud in inducing INSLAW to enter the contract modification. Pet. App. 227a.

28 U.S.C. § 157(a), (c); Pet. 19-20. The error of this holding is manifest from the opinion itself. According to the court of appeals, INSLAW's claims could not be violations of the stay because they would require the resolution of non-core matters. The foundation of the court of appeals' reasoning was that Art. III precluded a bankruptcy court from adjudicating "a wide range of 'non-core' disputes under the guise of an automatic stay violation." Pet. App. 13a. The Department similarly characterized INSLAW's complaint as asserting "related claims" and non-core "contract disputes." Opp. 12-14. Yet, the court of appeals denied the bankruptcy court jurisdiction over these "non-core" claims.

This holding cannot stand. It defeats the purposes of the 1984 bankruptcy reforms, and wastes the scarce resources of the debtor and the judiciary. The bankruptcy court in this case held a full and fair hearing on INSLAW's claims and the disputes raised by the Department. The bankruptcy court found, in 399 findings of fact and 71 conclusions of law, that (1) INSLAW was the sole owner of its trade secret software; (2) the Department fraudulently misappropriated that software and had no right to use it; and, (3) the Department further had no right to copy and install INSLAW's software in an additional 25 offices not covered by the contract. The district court performed an exhaustive *de novo* review and affirmed the findings entered by the bankruptcy court "under any standard of review." Pet. App. 50a-52a.

INSLAW therefore requests that this Court summarily reverse the court of appeals opinion and affirm the opinion of the district court.

CONCLUSION

The petition for writ of certiorari should be granted.

Michael E. Friedlander
Counsel of Record
Charles R. Work
Jacqueline E. Zins
Seth D. Greenstein
McDERMOTT, WILL
& EMERY
1850 K Street, N.W.
Suite 500
Washington, D.C. 20006
(202) 887-8000

Philip L. Kellogg
James L. Lyons
KELLOGG, WILLIAMS
& LYONS
1275 K Street, N.W.
Suite 825
Washington, D.C. 20005
(202) 898-0722

Counsel for Petitioner